



Signed and Filed: October 16, 2007

A handwritten signature in dark ink, appearing to read "T. E. Carlson", is written over a horizontal line.

THOMAS E. CARLSON
U.S. Bankruptcy Judge

UNITED STATES BANKRUPTCY COURT
FOR THE NORTHERN DISTRICT OF CALIFORNIA

In re)	Case No. 07-30309 TEC
)	
HUGO NERY BONILLA,)	Chapter 7
)	
Debtor.)	
)	
ATR-KIM ENG CAPITAL PARTNERS, INC.,)	Adv. Proc. No. 07-3079 TC
and ATR-KIM ENG FINANCIAL)	
CORPORATION,)	
)	
Plaintiffs,)	
)	
vs.)	
)	
HUGO NERY BONILLA,)	
)	
Defendant.)	

MEMORANDUM RE DEFENDANT'S RULE 12(b)(6) MOTION

Plaintiff obtained a \$24.5 million judgment against Defendant in Delaware state court. That court found that Defendant, a corporate director, breached his duty of loyalty to Plaintiff, a minority shareholder, by failing to take any steps to monitor the operations of the corporation. The Delaware court held Defendant liable for the loss Plaintiff suffered when the majority

MEMORANDUM RE MOTION
TO DISMISS COMPLAINT

1 shareholder transferred to himself substantially all of the
2 corporation's assets.

3 In the present action, Plaintiff seeks a determination that
4 Defendant's liability is nondischargeable under 11 U.S.C.
5 § 523(a)(4), because it arises from "defalcation while acting in a
6 fiduciary capacity". Defendant moves to dismiss that claim for
7 relief, contending that a corporate director is not a "fiduciary"
8 under section 523(a)(4).¹ For the reasons set forth below, the
9 motion is denied.

10 Whether a debtor is a fiduciary within the meaning of section
11 523(a)(4) is a question of federal law. Lewis v. Scott (In re
12 Lewis), 97 F.3d 1182, 1185 (9th Cir. 1996). First, the debtor must
13 have been subject to the duties of a trustee before, and without
14 reference to, the wrongdoing that gave rise to the debt. Id.
15 Second, the duties imposed on the debtor must be those imposed on
16 the trustee of an express or technical trust. Id. at 1185-86 n.1.
17 Thus, there must be an identifiable trust res, identifiable
18 beneficiaries, and the debtor must be subject to the duties of
19 loyalty, good faith, and honesty in caring for the trust res.
20 Lewis, supra, 97 F.3d at 1186 n.1; Miramar Resources, Inc. v.
21 Shultz (In re Shultz), 208 B.R. 723, 728 (Bankr. M.D. Fla.
22 1997)(Shultz II).

23 Whether a debtor is subject to the duties just described is
24 primarily a matter of state law. Lewis, supra, 97 F.3d at 1185.
25 The requisite duties can be imposed by agreement, state statute, or

26
27 ¹ Plaintiff is not urging that the decision of the Delaware
28 court be given issue-preclusive effect at this time. The findings
of fact in the state-court decision are treated as allegations for
the purpose of the present motion.

1 state case law. Id. at 1185-86. The parties here agree that
2 Delaware law defines Defendant's duties as a corporate director.

3 Numerous Delaware decisions refer to directors as trustees,
4 and impose on directors the highest duties of loyalty, honesty, and
5 fair dealing in all matters concerning the management of corporate
6 assets. See, e.g., Hynson v. Drummond Coal Co., Inc., 601 A.2d 570
7 (1991); Keenan v. Eshleman, 2 A.2d 904, 908 (1938). Furthermore,
8 Delaware cases impose this fiduciary duty prior to, and without
9 reference to, any misconduct by the director.

10 It is not always necessary for [directors] to reap a
11 personal profit or gain a personal advantage in order for
12 their actions in performance of their quasi trust to be
13 successfully questioned. Trustees owe not alone the duty
14 to refrain from profiting themselves at the expense of
15 their beneficiaries. They owe the duty of saving their
16 beneficiaries from loss.

17 Bodell v. General Gas & Electric Corp., 132 A. 442, 447 (1926).

18 Thus, Delaware case law clearly identifies the fiduciary duties of
19 a corporate director, the trust res (all corporate assets), and the
20 beneficiaries of the trust (the corporation and its shareholders).

21 Delaware court decisions do not, however, equate corporate
22 directors with trustees in all respects. The Bodell decision
23 quoted above refers to directors as "quasi" trustees. Id. Another
24 Delaware decision notes that trustees differ from corporate
25 directors in that trustees usually occupy a caretaking role, while
26 directors are often required to take risks with the assets they
27 manage. Cinerama, Inc. v. Technicolor, Inc., 663 A.2d 1134, 1148
28 (1994). Yet another Delaware decision states that corporate
directors are not trustees in the strictest sense, because they do
not hold legal title to the property of the corporation.

1 The officers and directors of a corporation are
2 fiduciaries but they are not real trustees. They do not
3 hold the legal title to the corporate property. They
4 occupy a position of extreme trust and confidence toward
all interested parties, and exercise great powers in
managing corporate affairs, but they are not trustees of
an express trust in the true sense of that term.

5 Bovay v. H.M. Byllesby & Co., 29 A.2d 801, 804 (1943) (citations
6 omitted); see also Shultz II, supra, 208 B.R. at 729 (Delaware
7 courts say directors are fiduciaries but "technically not
8 trustees"). The major authorities on trust law are in accord that
9 corporate directors occupy a trust-like position, but are not
10 trustees in the strict sense, because they do not directly hold
11 legal title for a beneficial owner. Bogert & Bogert, Law of Trusts
12 & Trustees § 16 (2007); accord Restatement (Third) of Trusts §§ 2,
13 5(g) (2003).

14 The Ninth Circuit states "the fiduciary relationship must be
15 one arising from an *express or technical trust* that was imposed
16 before and without reference to the wrongdoing that caused the
17 debt." Lewis, supra, 97 F.3d at 1185 (emphasis added). Does this
18 mean that in addition to preexisting the wrong, the fiduciary duty
19 must be identical to that of a trustee in every technical respect?

20 I conclude that the fiduciary duty must preexist the trust,
21 and must be *substantially similar* to the role of a trustee, in that
22 there must be a trust *res*, identifiable beneficiaries, and clear
23 notice of the duties of loyalty, honesty, and fair dealing toward
24 the beneficiaries in all matters affecting the trust *res*. In
25 Lewis, the Ninth Circuit found partners to be fiduciaries under
26 section 523(a)(4) upon the basis of state-court decisions that
27 imposed on partners the duties of loyalty, honesty, and fair
28 dealing. Id. at 1186. One of the decisions Lewis relied upon

1 described the duties of a partner as merely "similar to a
2 trustee's," and the other decisions cited failed to use the term
3 trustee at all in describing the duties of a partner.² In addition,
4 Lewis noted with approval language in Collier stating that the
5 duties of the fiduciary need only be "substantially similar" to
6 those imposed on trustees.

7 "If state law clearly and expressly imposes trust
8 obligations on managing partners of limited partnerships
9 substantially similar to those imposed on trustees, i.e.,
10 the duty of loyalty and the duty to deal with one another
11 in good faith and with honesty, these fiduciary
12 obligations meet the strict requirements of section
13 523(a)(4)".

14 Id. at 1186 n.1.

15 As noted above, the director of a corporation organized under
16 Delaware law is subject to duties substantially similar to those
17 imposed on the trustee of an express or technical trust, and those
18 duties arise before and without reference to any wrongdoing. The
19 director of a Delaware corporation is therefore a fiduciary within
20 the meaning of section 523(a)(4). Miramar Resources, Inc. v.
21 Shultz (In re Shultz), 205 B.R. 952, 959 (Bankr. D. New Mex. 1997)
22 (Shultz I); see Foster v. Lasagna, 609 F.2d 392, 396 (9th Cir.
23 1979)(director of corporation organized under California law is a
24 fiduciary for purpose of section 523(a)(4)); see also Nahman v.
25 Jacks (In re Jacks), 266 B.R. 728, 737 (9th Cir. BAP 2001)(same).

26 Defendant also argues that the Delaware judgment imposes
27 liability on him for acts that should be protected under the
28 business judgment rule. In essence, this is an argument that the

29 ² Desantis v. Dixon, 236 P.2d 38, 41 (Ariz. 1951) (does not
30 refer to partner as trustee); Jerman v. O'Leary, 701 P.2d 1205,
31 1210 (Ariz. App. 1985) (same); Carrasco v. Carrasco, 422 P.2d 411,
32 413 (Ariz. App. 1967) (duty of partner "similar to a trustee's").

1 facts alleged do not amount to a "defalcation" within the meaning
2 of section 523(a)(4). A defalcation generally does not include the
3 poor exercise of business judgment in carrying out an act that the
4 fiduciary was authorized to perform. Blyler v. Hemmeter (In re
5 Hemmeter), 242 F.3d 1186, 1191 (9th Cir. 2001).

6 The facts alleged here, however, constitute a complete failure
7 to take any action to preserve the assets of the corporation, and
8 therefore go well beyond the poor exercise of business judgment.

9 The Delaware court found:

10 Bonilla . . . acted as . . . [a] stooge for Araneta,
11 seeking to please him and only him, and having no regard
12 for [Bonilla's] obligations to act loyally towards the
13 corporation and all of its stockholders. Such behavior
14 is not indicative of a good faith error in judgment; it
15 reflects a conscious decision to approach one's role in a
16 faithless manner by acting as a tool of a particular
stockholder, rather than as an independent and impartial
fiduciary honestly seeking to make decisions for the best
interests of the corporation. . . . When required by
[Bonilla's] office to be loyal to the Delaware Holding
Company, Bonilla . . . chose total fealty to Araneta's
conflicting interests instead.

17 ATR-Kim Eng Financial Corp. v. Araneta, 2006 WL 3783520 at 1, 21
18 (Del. Ch. 2006). Defendant's alleged acts are less like an
19 unfortunate choice in the purchase of stock than they are like
20 leaving a large amount of cash unguarded in a public place. As
21 such, the alleged facts represent the type of failure to account
22 for trust property that has traditionally been the hallmark of
23 defalcation. Otto v. Niles (In re Niles), 106 F.3d 1456, 1460-62
24 (9th Cir. 1997).

25 ****END OF MEMORANDUM****

Court Service List

Iain A. Macdonald, Esq.
Law Offices of Macdonald & Associates
Two Embarcadero Center, Suite 1670
San Francisco, CA 94111-3930

Michael C. Fallon, Esq.
Law Offices of Michael C. Fallon
100 E Street, Suite 219
Santa Rosa, CA 95404

Michael J. Baker, Esq.
William J. Lafferty, Esq.
Matthew L. Beltramo, Esq.
Howard, Rice, Nemerovski, Canady,
Falk & Rabkin
Three Embarcadero Center, 7th Floor
San Francisco, CA 94111